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Finding the True Cost of Care: Children's Healthcare of Atlanta Takes on Activity - Based Costing

Written by Helen Adamopoulos | August 26, 2014

About two years ago, leaders at Children's Healthcare of Atlanta began to wonder if they could connect the facility's overhead costs to actual activity involved in treating the patient. That led to the launch of an organizational initiative that's changing how the hospital looks at the cost of providing care.

"The goal is to take overhead and move it into the direct [spending] as much as possible," says Mike Riley, CHOA's director of performance analytics.

The method CHOA is using is called activity-based costing — a way to determine the cost of a service or product based on the resources consumed. According to The Economist, ABC is seen as a way "to change the way in which costs are counted" and provides an alternative to traditional accounting, which involves allocating overhead or indirect costs in proportion to an activity's direct costs. The traditional method can prove problematic, as it doesn't reflect the true cost difference between services that require the same amount of direct costs but vary in their overhead (for instance, two products may require the same amount of workers and materials, but one may be more complex and take more of employees' time).

For hospitals and health systems facing pressure to become more efficient and contain spending, this costing methodology can provide a pathway for finding the real cost of healthcare services and utilization. So far, CHOA has applied activity-based costing to areas including environmental services (e.g., room cleaning for inpatients and outpatients based on clinical care area), diabetes education, patient access and medical records maintenance. The ABC method has helped the hospital realize that historically costs weren't accounted for appropriately according to utilization, Mr. Riley says.

For hospitals and health systems looking to start using ABC, Mr. Riley identified administrative costs as "easy wins." CHOA has re-categorized administrative departments and functions to tie their costs back to care delivery. For instance, he cites the emergency department patient access cost category. "It was easy to re-class those dollars into the ED," he says. "When we re-class them, those costs were spread based on the RVUs. Regardless if it's a level-one or a level-five patient, the same work is being done by that access staff. So we were able to say we're going to spread this cost evenly per patient."

Brad Webb, manager of cost analytics at CHOA, says it helps to have the support of hospital managers when adopting ABC. "They were excited about it," he says of CHOA's leaders. Additionally, he says communicating with departments and employees affected by the shift is crucial so that they understand what's happening.

Mr. Riley advises working with the operational department leads in areas where the hospital plans to move from an overhead to a direct cost component. "Make sure you understand how their services are delivered and what services you provide…so that when you start down this process you don't realize it's not what you thought it was," he says. "In a large organization…they might just look at the description on the cost center and decide how to spread overhead. That description of that department in the accounting system doesn't always match what they're doing on the ground."

CHOA has made a lot of progress with the new costing method, but it's only 50 to 60 percent done with its journey, according to Mr. Riley. "The last 40 percent is going to take longer," he says. "To get the operational buy-in on some of this is just going to take time." However, Mr. Riley and his colleagues are prepared to put in the effort.

"We're starting to have conversations on what are the next three departments we want to address," he says. "We're going to continue to push forward and push the envelope for the foreseeable future."